IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 171 of 1986

For Approval and Signature:

Hon'ble MR.JUSTICE A.R.DAVE
and
Hon'ble MR.JUSTICE D.A.MEHTA

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : NO

2. To be referred to the Reporter or not? : NO

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO

5. Whether it is to be circulated to the Civil Judge? : NO

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COMMISSIONER OF INCOME TAX

Versus

OM NILKANTH CHEMICALS (I) PVT LTD

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Appearance:

MR AKIL QURESHI for MR MANISH R BHATT for Petitioner No. 1

..... for Respondent No. 1

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CORAM : MR.JUSTICE A.R.DAVE
and
MR.JUSTICE D.A.MEHTA

Date of decision: 18/07/2001

ORAL JUDGEMENT

(Per : MR.JUSTICE A.R.DAVE)

At the instance of the revenue, the following question has been referred to this court for its opinion under the provisions of sec. 256(1) of the Income-tax Act, 1961 (hereinafter referred to as 'the Act') by the Income Tax Appellate Tribunal. Ahmedabad Bench 'A'.

"Whether on the material facts and the provisions of law the Appellate Tribunal is right in law in coming to the conclusion that the assessee is a financing (sic) company within the meaning of section 40A and hence the Income-tax Officer was not right in disallowing 15% of interest due on borrowed amounts u/s 40A(8) of the I.T. Act, 1961?"

2. We have heard learned advocate Shri Akil Qureshi appearing for the applicant. Though served, nobody has appeared for the respondent-assessee.

3. The facts giving rise to the present reference, in a nutshell, are as under:

3.1 The assessee is a private limited company. During the Assessment Years 1979-80 to 1983-84, the assessee was having income from business on account of its trading activity. In addition to the trading activity, the assessee was lending its funds to other persons and was earning income by way of interest.

3.2 During the said assessment years, the Assessing Officer disallowed 15% of the expenditure incurred by way of interest under the provisions of sec. 40A(8) of the Act. The assessee had contended before the Assessing Officer that the company was a financial company as referred to in sec. 40A(8) because the principal business of the assessee company was of providing finance. The assessee had therefore submitted before the Assessing Officer that 15% of the interest paid should not be disallowed on the ground that the company was a finance company.

3.3 The A.O. did not agree with the submission made by the assessee that the assessee was a financial company for the reason that the assessee was earning substantial amount from its trading activity whereas income received by way of interest was comparatively very less. Looking to the course we propose to adopt, we do not intend to go into the figures of profits earned by the assessee from its trading activity and the amount earned

by way of interest.

3.4 Being aggrieved by the order passed by the A.O., the assessee filed appeals before the CIT (Appeals). The appeals were allowed and submission to the effect that the assessee was a financial company was upheld and accordingly the disallowance of 15% of interest was deleted.

3.5 Being aggrieved by the common order passed in appeals by the CIT (Appeals), the revenue filed appeals before the Tribunal. The Tribunal dismissed the appeals and upheld the order passed by the CIT (Appeals) for the relevant assessment years.

4. The question which has been referred to this court is whether the Tribunal was right in coming to the conclusion that the assessee is a financial company within the meaning of sec. 40A(8) of the Act.

5. Upon perusal of the relevant orders, it appears that the CIT (Appeals) and the Tribunal had given more importance to only certain aspects and all relevant factors were not considered before coming to the conclusion that the assessee was a financial company.

6. The CIT (Appeals) and the Tribunal came to the conclusion that the assessee company was a financial company and, therefore, held that the disallowance of 15% of interest was not proper. Upon perusal of the Memorandum of Association of the company, they found that one of the main objects for which the company was formed was to borrow or raise money and to lend and advance money. Out of the seven main objects of the company, five objects pertain to business of finance and investment. Looking to the said fact, the CIT (Appeals) and the Tribunal came to the conclusion that the principal business of the assessee was to provide finance.

7. We have heard learned advocate Shri Akil Qureshi, who has submitted that the Tribunal was in error when it only looked at the Memorandum of Association of the company ignoring the fact that substantial amount was earned by the assessee company from its trading business. He has submitted that had the assessee company been a financial company and had the principal business of the assessee company been to provide finance, the assessee company would have earned much more money from its business of providing finance, but that being not the position, the assessee company could not have been termed

as a company having the principal business of providing finance and therefore the company was not a financial company. It has been stated by him that as the company was having substantial profits from its trading activity, the company ought to have been treated as a company doing trading activity as its principal activity.

8. According to the learned advocate, the real test was of the financial result of the trading activities of the assessee company. He has drawn our attention to the figures of trading activities. It has been shown that the profits from trading activity were increasing gradually whereas the profits from its financial business were very less and at times the company had also suffered loss in the business of borrowing and lending money. He has thus submitted that the principal business of the assessee company could not have been said to be of providing finance.

9. We have heard the learned advocate at length and have also perused the impugned orders passed by the CIT (Appeals) and the Tribunal. Upon perusal of the orders and looking to the financial results of the assessee company, we are of the opinion that the Tribunal had given undue importance to the fact that the main object of the assessee company, as depicted in the Memorandum of Association, was of lending and borrowing money. A company might have several objects. Simply because a company is having certain main objects, it would not mean that the other objects, with which the company has been incorporated, would become insignificant.

10. In our opinion, several relevant factors have not been considered by the Tribunal before coming to the conclusion that the company was a financial company. In our opinion, in addition to the Object Clause of the Memorandum of Association, there are so many other factors which ought to have been considered by the Tribunal. In this connection, we may refer to a judgment delivered by this court in the case of CIT v. Motilal Hirabhai Spg. & Wvg. Co. Ltd., 113 ITR 173. This Court had to consider in the said case whether the assessee was doing business as money lender and whether the amount of interest earned by the assessee was its business income. Simply because an assessee lends money to someone and earns interest therefrom would not make the assessee a money lender and as such it cannot be said that the assessee is in the business of money lending. The amount of interest which the assessee might receive in such a case need not become his business income. This Court had looked into several factors and had observed

that there are several factors which are to be considered before coming to the conclusion whether the assessee can be said to be in business of money lending. The said judgment can be of great assistance to determine whether a particular activity of a person can be said to be his business activity or principal business. Several factors which should be looked into for the purpose of determining whether a person is doing business or he is just engaged in a particular activity have been referred to in the said judgment. In our opinion, the law laid down by this Court in the said judgment ought to have been looked into by the Tribunal before coming to the conclusion that the principal business of the assessee was of providing finance.

11. Unfortunately, we do not have all relevant material to determine whether providing finance was the principal business of the assessee company. In absence of relevant material, it would not be possible for this Court to answer the question and, therefore, we decline to answer the question referred to us, but we direct the Tribunal to permit the parties to lead necessary evidence and upon perusal of the evidence which might be led and which might be on the record, the Tribunal should decide afresh whether the assessee company was a financial company during the relevant assessment years.

12. We, therefore, decline to answer the question referred to us and return the reference unanswered and direct the Tribunal to decide the appeals afresh after giving necessary opportunity to the concerned parties for leading evidence. We are sure that the Tribunal will look into all the relevant factors and take appropriate decision after considering the same.

The reference thus stands disposed of with no order as to costs.

(A.R. Dave, J.)

(D.A. Mehta, J.)

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